IN THE

Supreme Court of the United States

October Term, 1977

No. 77-99

UTAH STATE UNIVERSITY OF AGRICULTURE AND APPLIED SCIENCE, *Petitioner*,

vs.

BEAR, STEARNS & CO. et al., *Respondents*

BRIEF OF RESPONDENTS BEAR STEARNS & CO., HORNBLOWER & WEEKS-HEMPHILL, NOYES, INC., SHEARSON, HAMMILL & CO., SUTRO & CO., INC. AND MERRILL LYNCH, PIERCE, FENNER & SMITH, INC. IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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These Respondents disagree with the question presented and statement of the case as set forth in the Petition for Certiorari. Accordingly, they present the question at issue and the statement of the case as follows:

QUESTION PRESENTED

Whether, in the absence of allegations of scienter, extensions of credit by a securities broker-dealer in violation of Regulation T of the Federal Reserve System (governing the extension of credit by broker-dealers for the purpose of purchasing or carrying securities) give rise to a private cause of action by a customer where the extensions

of credit occurred after the promulgation of Federal Reserve System Regulation X (governing the obtaining of securities credit by borrowers).

STATEMENT OF THE CASE

The Petition involves eight companion cases filed by Petitioner Utah State University of Agriculture and Applied Science (hereinafter "the University") against seven corporations or partnerships engaged as broker-dealers in the securities industries (hereinafter referred to as "broker-dealers"). Case No. 75-1861 in which Sutro & Co. is named defendant contains no allegations of violations by it of the federal securities laws here at issue and for this reason should not have been included in the University's petition. The following representations and arguments relate only to those actions other than the Sutro action.

The complaints were filed in September, 1974, with the exception of the complaint in Case No. 75-1330 which was filed in November, 1975, in the United States District Court for the District of Utah and allege that the broker-dealers, among other things, failed to comply with section 7(c) of the Securities Exchange Act of 1934 and Regulation T promulgated thereunder by the Board of Governors of the Federal Reserve System by failing to liquidate the University's orders for securities purchases when the University failed to make payment for the same within the time set by Regulation T. Neither section 7(c) nor Regulation T explicitly provide for a private right of action by a customer against his broker-dealer. The transactions at issue occurred after congressional enactment of section 7(f) of the '34 Act and the promulgation thereunder of Regulation X by the Federal Reserve System. The complaints contain no allegation that the broker-dealers' alleged violation of Regulation T was in any way fraudulent or deceitful.

The district court granted the broker-dealers' motions to dismiss in each action with the exception of Case No. 75-1862, in which the court granted the broker-dealer's motion for judgment on the pleadings. The district court so ruled upon the facts alleged after concluding that any implied right of action arising under section 7(c) of the '34 Act and Regulation T was eliminated by enactment of section 7(f) of the '34 Act and the promulgation of Regulation X thereunder. In the alternative, the court granted the broker-dealers summary judgment because even if an implied right of action remains under Regulation T, the University was *in pari delicto* with the broker-dealers as to any violation of Regulation T under the uncontroverted facts. (The court requested discovery of facts relating to the University's knowledge and sophistication in securities transactions in order to treat the motion to dismiss as a Rule 56 motion for summary judgment pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure.)

In a unanimous decision, the United States Court of Appeals for the Tenth Circuit affirmed, holding that no private right of action exists for violation of Regulation T under the facts alleged. The Tenth Circuit implied, however, that a private action may remain where fraudulent or deceitful conduct is alleged (Page A-12 of Appendix). The University petitioned the Tenth Circuit for a rehearing and suggested that it be heard en banc. Its petition was denied on March 18, 1977.

ARGUMENT

Contrary to the University's arguments, there is no reason for this Court to review the Tenth Circuit's holding with respect to Regulation T. Rather, there is good

reason not to review that decision: the Tenth Circuit opinion does not conflict with any other circuit court decision and does not present an important question of federal law which has not been, or should be, settled by this Court.

A. THE OPINION OF THE COURT OF APPEALS FOR THE TENTH CIRCUIT IS NOT IN CONFLICT WITH ANY OTHER CIRCUIT COURT DECISION.

The University erroneously asserts that the decision rendered by the Tenth Circuit is contrary to a substantial body of case law which has arisen with regard to the existence of an implied cause of action under section 7(c) and Regulation T. In fact, there is no conflict between the circuits on this issue. On the contrary, the one circuit, the Second, to address the issue raised by the University, first suggested the position taken by the Tenth Circuit. *Pearlstein v. Scudder & German,* 527 F.2d 1141 (2nd Cir. 1975) (*"Pearlstein II"*). And the only district court case Petitioner cites as taking a contrary position is not in direct conflict with the Tenth Circuit Court opinion. *McNeal v. Paine, Webber, Jackson & Curtis, Inc.,* 429 F. Supp. 359 (N.D. Ga. 1977). These and other cases will be dismissed more fully, *infra.*

Regulation T, 12 C.F.R. 220.1 et seq., was promulgated pursuant to section 7(c) of the Securities Exchange Act of 1934 and provides for purposes material here that a broker-dealer must liquidate a customer's order for the purchase of a security if the customer fails to make payment within a certain time. Neither section 7(c) nor Regulation T places any burden or obligation for compliance upon the customer. Because the burden of compliance rests solely on the broker-dealer, the Second Circuit in a divided decision in *Pearlstein v. Scudder & German,* 429 F.2d 1136 (2nd Cir. 1970), *cert. denied,* 401 U.S. 1013 (1971) (*"Pearlstein I"*),

found an implied cause of action in favor of the customer and against the broker-dealer. Other circuits, in decisions cited by the University in its Petition, took the same view. Then in 1970, Congress amended section 7 by adding subsection (f) and the Board of Governors of the Federal Reserve System promulgated thereunder Regulation X, 12 C.F.R. 224.1-224.6, which placed the burden of compliance with Regulation T (and other regulations relating to the extension of credit for the purpose of purchasing or carrying securities) upon the customer as well as the broker-dealer. Regulation X at 12 C.F.R. 224.2(a) states:

> A borrower shall not obtain any purpose credit from within the United States unless he does so in compliance with the following conditions:
>
> • • •
>
> (2) credit obtained from a broker/dealer shall conform to the provisions of Part 220 of this chapter (Regulation T), which is hereby incorporated in this part (Regulation X).

Because the burden for compliance with Regulation T was shifted from the broker-dealer to both the broker-dealer and the customer, the Second Circuit in *Pearlstein II, supra,* concluded at 527 F.2d at 1145 n.3, that:

> The effect of these developments is to cast doubt on the continuing validity of the rationale of our prior holding.

Apart from the Second and Tenth Circuits, no other court of appeals has addressed the issue. All other circuit opinions on Regulation T pertain to facts predating section 7(f) and Regulation X and for this reason do not treat the issue raised by Petitioner here and could not conflict with the decision of the Tenth Circuit. The University attempts to bring these early circuit decisions into conflict by making the unfounded suggestion that the Tenth

Circuit opinion, like the early decisions of the other circuits, somehow did not take into account or rest upon section 7(f) and Regulation X. That portion of the Tenth Circuit opinion reproduced at pages A-11 through A-13 of the Appendix makes clear that the opinion squarely rests upon this recent congressional and regulatory action.

The only case Petitioner seriously contends to be in conflict with the Tenth Circuit holding is a district court opinion and not a circuit decision. *McNeal v. Paine, Webber, Jackson & Curtis, Inc.*, 429 F. Supp. 359 (N.D. Ga. 1977). Even so, it is clear that this decision is not inconsistent with the Tenth Circuit. In *McNeal*, the district court agreed with the Tenth Circuit that the enactment of section 7(f) and the promulgation of Regulation X places in doubt the right of a customer to recover for margin violations of its broker. 429 F. Supp. at 365. It held, however, that a private right of action under Regulation T might still exist where an investor has been affirmatively misled by his broker into believing that his account is in compliance with Regulation T, and as a result, suffers tangible losses when his broker sells certain stocks at an unfavorable price in order to comply belatedly with that regulation. Significantly, there is no similar allegation here that the broker-dealers affirmatively misled the University into believing that it was in compliance with Regulation T or X and there is no allegation that the broker-dealers caused the University a loss by liquidating any of the University's orders for purchases in order for the broker-dealers to comply belatedly with Regulation T.

In its Petition, the University suggests that the Tenth Circuit's holding is so narrow that no private right of action may be implied under any circumstances. This is not correct. The Tenth Circuit implied that an action may still be maintained where fraud or deceptive conduct is

alleged. It did so by rejecting as "not pertinent" a ruling by the Northern District of Illinois, *Neill v. David A. Noyes & Co.*, 416 F. Supp. 78 (N.D. Ill. 1976), that an implied action still exists under Regulation T, because in that case, unlike in this action, fraud or deceptive conduct was alleged. This would conform to this Court's holding in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, *reh. denied*, 425 U.S. 986 (1976), with respect to another section of the '34 Act not explicitly providing for private suits, section 10(b). There the Court implied a private cause of action only where scienter — intent to deceive, manipulate, or defraud — is alleged.

Because no other circuit court is in conflict with the Tenth Circuit's holding, the University's Petition for Certiorari should be denied.

B. THE QUESTION PRESENTED IS NOT AN IMPORTANT QUESTION OF FEDERAL LAW WHICH HAS NOT BEEN, BUT SHOULD BE, SETTLED BY THIS COURT.

Contrary to the University's argument, the participation by the Federal Reserve Board as amicus curiae in the University's petition for rehearing before the Tenth Circuit does not elevate the question presented to an important question of federal law. The Federal Reserve Board continues to have the right to seek compliance with section 7 and the regulations promulgated thereunder. Petitioner suggests that because the Federal Reserve Board opposed the Tenth Circuit ruling that this alone is evidence of error and for this reason the Petition raises an important question of federal law. This Court has often given little credence to an agency's view in determining whether private rights of action arise out of statutes or regulations. In *Piper v. Chris-Craft Industries, Inc.*,

51 L. Ed. 2d 124, 97 S.Ct. 926 (1977), the Court stated with respect to the position taken by the Securities & Exchange Commission that the Williams Act, section 14(e) of the '34 Act, implies a private right of action for an unsuccessful tender offeror, 51 L. Ed 2d at 153 n.27:

> Even if the agency spoke with a consistent voice, however, its presumed "expertise" in the securities-law field is of limited value when the narrow legal issue is one peculiarly reserved for judicial resolution, namely whether a cause of action should be implied by judicial interpretation in favor of a particular class of litigants. Indeed, in our prior cases relating to implied causes of action, the Court has understandably not invoked the "administrative deference" rule, even when the SEC supported the result reached in the particular case. J. I. Case v. Borak, supra; Superintendent of Insurance v. Bankers Life & Cas. Co. That rule is more appropriately applicable in instances where, unlike here, an agency has rendered binding, consistent, official interpretations of its statute over a long period of time [citations omitted].

The Federal Reserve Board has not rendered "binding, consistent, official interpretations" of section 7(c) or Regulation T that an implied private right of action exists in favor of a broker-dealer's customer.

Petitioner also contends that the question presented is an important federal question because, it asserts, Congress relies upon actions by private litigants for enforcement of Regulation T. This argument simply begs the question of congressional intent and of itself does not create an important question of federal law. At the very least, the University should offer some evidence of any such legislative intent. It has not, because there is little or none. Indeed, the fact that Congress amended section 7 to undermine the basis upon which numerous courts had

repeatedly found implied private remedies evidences a contrary legislative intent.

Lastly, it is evident that the question presented is not an important question of federal law because, despite the volume of credit extended in this country for the purpose of purchasing or carrying securities, only one circuit, the Tenth, has been asked to confront this issue directly since the passage of section 7(f) in 1970.

CONCLUSION

For the reasons set forth above, Respondent broker-dealers respectfully submit that Petitioner has failed to raise any issue meriting review by this Court. There are no conflicts among the circuits and the question presented is not an important question of federal law. Only one circuit, the Tenth, has squarely ruled on the issue raised and the only other circuit, the Second, even to approach the issue has indicated that it would likely take the same position. The Petition for Writ of Certiorari should be denied.

Respectfully submitted this 14th day of September, 1977.

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